



NEW YORK
CITY BAR

Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

**REPORT BY THE COMMITTEE ON TRUSTS, ESTATES
AND SURROGATES COURTS
AND THE COMMITTEE ON ESTATE AND GIFT TAXATION
IN SUPPORT OF PROPOSED AMENDMENT TO
SECTION 10-6.6(B) OF THE ESTATES, POWERS AND TRUSTS LAW
AND RESTATEMENT OF THE STATUTE AS SECTION 10-6.6-A**

INTRODUCTION

Section 10-6.6(b) of the Estates, Powers and Trusts Law codified decisional law that permitted a trustee who has authority to invade the trust principal to exercise that power by creating new trusts.¹ The potential uses² of this statute compel the enactment of a New York statute that is expansive rather than restrictive in nature, one that permits more flexibility and liberalizes the current statute. Nine other state statutes, which were all enacted after the New York statute, provide greater flexibility than the New York statute.³ The Trusts, Estates and Surrogates Courts Committee and the Estate and Gift Taxation Committee of the Association of

¹ *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782 (1940).

² These uses include addressing changed circumstances; modifying administrative provisions; reducing administrative costs (*Matter of Vetlesen*, NYLJ June 29, 1999, p. 27, col. 3 (Surr. Ct. NY County) wherein a sole trustee appointed principal of an *inter vivos* trust to himself and another as trustees of a testamentary trust and the trustees agreed to share one commission.); altering trusteeship provisions; extending the termination date of a trust (*In re Alfred Hazan*, NYLJ April 11, 2000 (Surr. Ct. Nassau County) wherein a trustee was permitted to extend a trust for a beneficiary's lifetime. See also *Matter of Riese*, NYLJ May 8, 1995, p. 30, col.3 (Surr. Ct. NY County) wherein the trustees of two irrevocable trusts subject to New York law, which were to end at the first to die of the grantor and the beneficiary, were allowed to pay over the assets to substantially identical Florida trusts which were to last for the beneficiary's lifetime in order to protect the trusts assets from New York real property transfer gains taxes); correcting drafting errors; converting a non-grantor trust to a grantor trust or the reverse; changing a trust's governing law (*Matter of Riese*, *supra*.); dividing trust property to create separate trusts; reducing potential liability (*Matter of Kaskel*, 620 NYS2d 217 (Surr. Ct. NY County 1994) wherein trustees of several family trusts, which included spendthrift provisions, were allowed to terminate the existing trusts and pay over assets to new trusts without spendthrift provisions so that the beneficiaries could assign their interests in distressed real estate properties from the trusts to corporations for liability protection); making a trust interests spendthrift or the reverse (*Matter of Rockefeller*, NYLJ, August 24, 1999, p. 28, col. 2 (Surr. Ct. Nassau County) wherein a committee with discretionary distribution authority over a trust was permitted to pay trust assets to a new trust to shelter principal by providing a spendthrift restraint); and converting a trust into a supplemental needs trust to permit a beneficiary to qualify for certain governmental benefits (*Estate of Grosjean*, NYLJ December 10, 1997, p. 35, col. 6 (Surr. Ct. Nassau County) wherein a trustee was permitted to convert a testamentary trust to a supplemental needs trust; See also *In re Estate of Alfred Hazan*, *supra*).

³ Alaska Stat. 13.36.157; Arizona Revised Statutes, Section 14-10819; Delaware Code Ann Tit. 12 § 3528; Florida Statute sec. 736.04117(1); New Hampshire Revised Statutes § 564-B:4-418; Nevada Revised Statutes Chapter 163 (2009); North Carolina General Statutes § 36C-8-816.1; South Dakota Statute Section 55-2-15; and Tennessee Code Ann. 35-15-816.

the Bar of the City of New York (the “Committees”) propose a revision to Section 10-6.6(b).⁴ In light of the substantial amount of changes, the Committees propose that the statute is restated in its entirety as Section 10-6.6-A.

OVERVIEW OF CHANGES

The proposed provision makes a number of notable clarifications and changes to the existing statute. First, the proposed provision permits a trustee to pay over the principal of a trust to a new trust even if the trustee does not have absolute or unlimited discretion to invade the principal of the trust. Second, there is no requirement to file the instrument exercising the power to appoint with the clerk of the court having jurisdiction over the trust. Third, the proposed provision clarifies the operation of the statute in the context of a multi-beneficiary trust. Fourth, the proposed provision protects certain tax results that could otherwise be lost.

The proposed provision retains the concept that the exercise of the power to invade the principal of the trust is considered the exercise of a special power of appointment.⁵ Most important, the proposed provision retains the ability of the settlor of the trust to override the application of this statute in the trust agreement.⁶ The proposed provision also retains the present law provision that the statute not be construed to abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument or under any other provision of law or under common law or as directed by any court having jurisdiction over the invaded trust.⁷ The proposed statute also retains the present law that a trustee may not exercise a power to decrease or indemnify against a trustee’s liability⁸ and further provides that the appointed trust cannot eliminate a provision in the invaded trust granting another person the right to remove or replace the authorized trustee exercising the power.⁹

The proposed provision contains several important new concepts. One clarifies that no trustee shall be liable for failing to use the statute: the proposed provision states that the existence of the statute itself is not intended to create an inference or duty that a trustee of a trust should exercise the powers in the statute.¹⁰ Another new provision clarifies that the exercise of the power to invade principal is not prohibited by the fact that the invaded trust includes a spendthrift clause or a provision that prohibits amendment or revocation of the trust.¹¹

⁴ The act of invading the trust principal under this statute is called “decanting” and Section 10-6.6(b) is referred to as the “decanting statute.”

⁵ EPTL 10-6.6(f); Proposed EPTL 10-6.6-A(c)

⁶ EPTL 10-6.6(b); Proposed EPTL 10-6.6-A(k). The Committees note that there are limitations on the ability to override the statute as revised. A preexisting trust may not usually be amended to override the application of the statute.

⁷ EPTL 10-6.6(g); Proposed EPTL 10-6.6-A(i)

⁸ This applies to both testamentary and *inter vivos* trusts.

⁹ Proposed EPTL 10-6.6-A(l) (2) and (3)

¹⁰ Proposed EPTL 10-6.6-A(j)

¹¹ Proposed EPTL 10-6.6-A(k)

DISCUSSION OF PROPOSED REVISIONS

A. DEFINITIONS

1. Present Law

The current statute includes only one definition, which is the phrase “all persons interested in the trust,” and otherwise relies on the incorporation of defined terms by reference to other statutes or relies on decisional law, common law, and common meaning.

2. Reasons for Change

It would facilitate the use and application of the statute if the statute specifically included more defined terms.

3. Explanation of Proposed Provision

The proposed provision adds the following definitions:¹² “appointed trust,” “authorized trustee,” “Code,” “current beneficiary(ies),” “invade,” “invaded trust,” “person(s) interested in the invaded trust,” “principal,” and “unlimited discretion.” Notably, the definition of “authorized trustee” clarifies and limits the trustees who may exercise the pay over power; including such a specific definition of trustee limits the abuse potential of the statute and prevents unintended adverse tax consequences.

The proposed provision includes the following defined terms:

- The term “appointed trust” means an irrevocable trust which receives principal from an invaded trust under paragraph (a) or (b) including a new trust created by the creator of the invaded trust or by the trustees, in that capacity, of the invaded trust.¹³ For purposes of creating the new trust, the requirement of 7-1.17 that the instrument be signed by the creator shall be deemed satisfied by the signature of the trustee of the appointed trust.
- The term “authorized trustee” means, as to an invaded trust, any trustee or trustees with authority to pay trust principal to or for one or more current beneficiaries other than (i) the creator or (ii) a beneficiary to whom income or principal must be paid currently or in the future, or who is or will become eligible to receive a distribution of income or principal in the discretion of the trustee (other than by the exercise of a power of appointment held in a non-fiduciary capacity).
- References to sections of the “Code” refer to the United States Internal Revenue Code of 1986, as amended from time to time, or to corresponding provisions of

¹² Proposed EPTL 10-6.6-A(q)

¹³ Present law provides that the trustee may exercise discretion by appointing all or part of the principal “in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument.” EPTL 10-6.6(b)(1)

subsequent internal revenue laws, and also refer to corresponding provisions of state law.¹⁴

- The term “current beneficiary(ies)” means the person or persons (or as to a class, any person or persons who are or will become members of such class) to whom the trustees may distribute principal at the time of the exercise of the power.
- The term “invade” shall mean the power to pay directly to the beneficiary of a trust or make application for the benefit of the beneficiary.
- The term “invaded trust” means any existing irrevocable inter vivos or testamentary trust whose principal is appointed under paragraph (a) or (b).
- The term “person(s) interested in the invaded trust” shall mean any person(s) upon whom service of process would be required in a proceeding for the judicial settlement of the account of the trustee, taking into account section 315 of the surrogate’s court procedure act.
- The term “principal” shall include the income of the trust at the time of the exercise of the power that is not currently required to be distributed, including accrued and accumulated income.
- The term “unlimited discretion” means the unlimited right to distribute principal that is not modified in any manner. A power to pay principal that includes words such as best interests, welfare, comfort, or happiness shall not be considered a limitation or modification of the right to distribute principal.

B. TRUSTEE’S POWER TO MAKE DISTRIBUTIONS UNDER TERMS OF INVADED TRUST

1. Present Law

Unless the terms of a trust expressly provide otherwise, a trustee must have “absolute discretion” to invade the principal of a trust for the benefit of a beneficiary. The current statute provides as follows:

“A trustee who has the absolute discretion, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of one or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that the exercise of such discretion (A) does not reduce any fixed income interest of any income

¹⁴ Proposed EPTL 10-6.6-A(q)(4). This definition is the same definition used in EPTL 7-1.13(i). The Committees note that the EPTL does not have a definition of the Internal Revenue Code and that there are inconsistent references to the Internal Revenue Code throughout the law.

beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of 11-1.7;”¹⁵

2. Reasons for Change

Conceptually, the ability to distribute principal outright inherently includes the ability to distribute principal in a more limited manner, including in further trust, unless the terms of the governing instrument expressly provide otherwise. To enhance flexibility, the ability to invade principal for any purpose, rather than the ability to invade principal only if the trustee has absolute discretion, should trigger the ability of the trustee to pay from one trust to another. So long as the trustee has the ability to distribute principal for some purpose, for example, if the trustee may make principal distributions for a beneficiary’s health, education, maintenance, and support, but may not otherwise invade principal, the trustee should have the ability to pay the trust funds to a new trust *for the same purpose*. This opportunity should exist regardless of whether a beneficiary has the current need for funds.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(a) An authorized trustee with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust for, and only for the benefit of, one, more than one or all of the current beneficiaries of the invaded trust and one, more than one or all of the successor and remainder beneficiaries of the invaded trust (to the exclusion of any one or more of such current, successor, and remainder beneficiaries).”

“(b) An authorized trustee with the power to invade trust principal but without unlimited discretion may appoint part or all of the principal of the trust to a trustee of an appointed trust, provided that the current beneficiaries of the appointed trust shall be the same as the current beneficiaries of the invaded trust and the successor and remainder beneficiaries of the appointed trust shall be the same as the successor and remainder beneficiaries of the invaded trust.

(1) If the authorized trustee exercises the power under this paragraph, the appointed trust shall include the same language authorizing the trustee to distribute the income or invade the principal of the appointed trust as in the invaded trust.

(2) If the authorized trustee exercises the power under this paragraph to extend the term of the appointed trust beyond the term of the invaded trust, for any period after the invaded trust would have otherwise terminated under the provisions of the invaded trust, the appointed trust may provide the trustees with unlimited discretion to invade the principal of the appointed trust during such extended term.”

¹⁵ EPTL 10-6.6(b)(1)

“(c) An exercise of the power to invade trust principal under paragraphs (a) and (b) shall be considered the exercise of a special power of appointment as defined in 10-3.2.

(d) The appointed trust to which an authorized trustee appoints the assets of the invaded trust may have a term that is longer than the term set forth in the invaded trust, including, but not limited to, a term measured by the lifetime of a current beneficiary.

(e) If an authorized trustee has unlimited discretion to invade the principal of a trust and the same trustee or another trustee has the power to invade principal under the trust instrument which power is not subject to unlimited discretion, such authorized trustee having unlimited discretion may exercise the power of appointment under paragraph (a).

(f) An authorized trustee may exercise the power to appoint in favor of an appointed trust under paragraphs (a) and (b) whether or not there is a current need to invade principal under the terms of the invaded trust.”

“(i) This section shall not be construed to abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument of a trust or under any other provision of law or under common law, or as directed by any court having jurisdiction over the trust.”

“(k) A power authorized by paragraph (a) or (b) may not be exercised if expressly prohibited by the terms of the governing instrument, but a general prohibition of the amendment or revocation of the invaded trust or a provision that constitutes a spendthrift clause shall not preclude the exercise of a power under paragraph (a) or (b).

(l) An authorized trustee may not exercise a power authorized by paragraph (a) or (b) to effect any of the following:

(1) To reduce, limit or modify any beneficiary’s current right to a mandatory distribution of income or principal, a mandatory annuity or unitrust interest, a right to withdraw a percentage of the value of the trust or a right to withdraw a specified dollar amount, provided that such mandatory right has come into effect with respect to the beneficiary. Notwithstanding the foregoing, but subject to the other limitations in this section, an authorized trustee may exercise a power authorized by paragraph (a) or (b) to appoint to an appointed trust that is a supplemental needs trust that conforms to the provisions of 7 1.12.”

(2) To decrease or indemnify against a trustee’s liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence and prudence.

(3) To eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the power under paragraph (a) or (b) unless a court having jurisdiction over the trust specifies otherwise.

(4) To make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise.”

“(n) An authorized trustee may not exercise a power described in paragraph (a) or (b) in violation of the limitations under 9 1.1, 10-8.1 and 10-8.2, and any such exercise shall void the entire exercise of such power.”

4. Explanation of Proposed Provision

Unless expressly limited by the terms of the invaded trust, a majority of the trustees, acting in a fiduciary capacity, who have authority under the terms of an invaded trust to invade principal, whether or not there is a current need to invade principal under any standard stated in the invaded trust, may pay part or all of the principal of the invaded trust to an appointed trust.¹⁶ The principal that may be appointed may include the income of the trust that is accrued, accumulated, or otherwise on hand at the time of the exercise of the power that is not required to be distributed.¹⁷

Interests in the trust that are vested absolute may not be affected by paying the assets to a new trust or by the grant of a power of appointment in the appointed trust (see discussion in C, below); if a beneficiary has the right to receive all of the income of the trust, that right to receive all of the trust income must continue in the appointed trust.¹⁸ This limitation applies if the person is referred to by name or by another label, or falls within the class of persons who have a vested right.

Similarly, if the invaded trust does not give a trustee unlimited discretion, for example if the trust states a standard for distributions within the meaning of section 674(b)(5)(A) of the Code, the appointed trust must include the *same* standard.¹⁹ This means that if the invaded trust provides that beneficiaries are entitled to receive distributions for their health, education, and support, the appointed trust must also provide that those same beneficiaries are entitled to receive distributions for their health, education, and support. This is not necessary if the trust *also* gives a trustee the unlimited discretion to invade principal; if a trustee has unlimited discretion to invade principal and the same trustee or another trustee has the power to invade principal which is not unlimited discretion, the authorized trustee may exercise the power of appointment as if the trustee only had unlimited discretion as unlimited discretion trumps any stated standard.²⁰

¹⁶ Proposed EPTL 10-6.6-A(a)

¹⁷ See definition of “principal” in Proposed EPTL 10-6.6(A)(q)(8).

¹⁸ EPTL 10-6.6A(l)(1)

¹⁹ Proposed EPTL 10-6.6-A(b)(1)

²⁰ Proposed EPTL 10-6.6-A(e). Although the proposed provision permits the pay over of assets from one trust to another when the invaded trust includes language that is not unlimited discretion, there are limits on narrowing the beneficiaries and on granting a power to appoint under such circumstances. See discussion in C, *infra*.

Furthermore, notwithstanding the foregoing, a “change” in the dispositive terms of the invaded trust effected by paying to a new trust under the proposed provision may not reduce, limit, or otherwise change mandatory distributions of income, or mandatory annuity or unitrust interests, or a right annually to withdraw a percentage of the value of the trust, or a right annually to withdraw a specified dollar amount after such annual right to withdraw a percentage or specified dollar amount *has come into effect* with respect to the beneficiary.²¹ Changes that impact such mandatory rights may be made only when the trust pays over to an appointed trust that is a supplemental needs trust that conforms to Section 7-1.12 of the EPTL,²² but such changes may not be made if the change would jeopardize any tax benefit expected in the invaded trust.²³

The Committees recognize that the exercise of a trustee’s authority under this statute could raise a greater number of issues in the context of a trust for multiple beneficiaries than in the context of a trust with only a single beneficiary. The Committees considered limiting the extended application of the statute to trusts with only a single beneficiary, but concluded that the interests of multiple beneficiaries could adequately be protected under the new statute, so there was no reason to so limit the statute.

The proposed provision also specifically provides that the appointed trust to which an authorized trustee appoints the assets may have a term that is longer than the term set forth in the invaded trust, including a term measured by the lifetime of a current beneficiary.²⁴

C. BENEFICIARIES OF THE APPOINTED TRUST

1. Present Law

The current statute provides that “[a] trustee who has the absolute discretion, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of one *or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust ... provided, however, that the exercise of such discretion ... (B) is in favor of the proper objects of the exercise of the power...*”²⁵

2. Reasons for Change

The Committees believe that the integrity and sanctity of the trust and the wishes of the settlor could be undermined if the trustee could reconstitute a trust with different beneficiaries. As discussed in B, above, conceptually, the ability to distribute principal outright inherently includes the ability to distribute principal in a manner short of outright, including in further trust. Paying to a trust that includes a provision granting a beneficiary *otherwise entitled to receive the property outright* a power of appointment is consistent with current law and would also be

²¹ EPTL 10-6.6(b)(1)(A) and (b)(2)(A); Proposed EPTL 10-6.6-A(1)(1)

²² *Ibid*

²³ Proposed EPTL 10-6.6-A(m). See discussion in D, *infra*.

²⁴ Proposed EPTL 10-6.6-A(d)

²⁵ EPTL 10-6.6(b)(1), *emphasis added*.

consistent with the goal of the statute; because the beneficiary could receive the principal outright, it would be consistent to permit the beneficiary to exercise a power of appointment and appoint all or a portion of the trust to new or different beneficiaries as the beneficiary sees fit, including the power to add a class of beneficiaries broader than and different from the current, successor, and remainder beneficiaries of the invaded trust.²⁶ In this way, the beneficiary may, for example, avoid or postpone the imposition of a generation-skipping transfer tax on a trust by exercising a power of appointment to add a non-skip person to the class of beneficiaries.²⁷ This same rationale should apply when the appointed trust authorizes distributions that are not based on an unlimited standard. The Committees have concluded, however, that if the invaded trust does not give the trustee unlimited discretion to invade principal, the ability to alter the beneficiaries of the invaded trust or grant a power of appointment must be limited in order that the settlor's wishes are not undermined. The Committees endeavored to develop a bright line test for this approach.

The proposed provision also should clarify that the beneficiaries of the appointed trust would include beneficiaries covered in the class regardless of whether the beneficiary becomes a member of the class after the pay over to the appointed trust.

3. Relevant Portions of the Proposed Provision: EPTL Section 10-6.6-A

“(a)(1) An authorized trustee exercising the power under this paragraph may grant a power of appointment (including a presently exercisable power of appointment) in the appointed trust to one or more of the current beneficiaries of the invaded trust, provided that the beneficiary granted a power to appoint could receive the principal outright under the terms of the invaded trust.

(2) If an authorized trustee grants a power of appointment, the permissible appointees may be broader than or different from any beneficiaries of the invaded trust.

²⁶ This position is also supported by the decisional law *e.g.*, *Cheever v. Cheever*, 172 A.D. 353, 157 N.Y.S. 428 (1st Dep't 1916). *Matter of Moore*, 129 Misc. 2d. 639, 493 N.Y.S. 2d. 924 (Sup. Ct N.Y. County 1985); *See also* EPTL 10-6.6 *Practice Commentaries*.

²⁷ The Committees note that a trustee's payment of the assets from one trust to another could be considered the making of a gift by the beneficiaries of the invaded trust to the beneficiaries of the appointed trust. This payment, however is not the result of a voluntary transfer by the beneficiaries, and, therefore, not a gift by the beneficiaries. *See Estate of Anthony Di Marco v. Com'r*, 87 TC 518 (1986) acq. IRB 1990-39,4 (September 24, 1990) (decendent held not to have made a taxable gift of property interest in a survivors income benefit because he did not “transfer” the property as required by Section 2501(a)(1) of the Code where his participation in the plan was involuntary, he had no power to select or change the beneficiaries, no power to alter the amount or timing of the payment of the benefit, and no power to substitute other benefits for those prescribed by the plan). *See also* Treasury Regulations Section 25.2511-2(a). The Committees also note that a trustee who is not a beneficiary may not make a gift of trust property. *Eric F. Saltzman and Victoria M. Saltzman v. Com'r*, 131 F.3d 87 (2nd Cir. 1997); Regulations Section 25.2511-1(g)(1) (“[a] transfer by a trustee of trust property in which he has no beneficial interest does not constitute a gift by the trustee (but such a transfer may constitute a gift by the creator of the trust, if until the transfer he had the power to change the beneficiaries by amending or revoking the trust”); and Blattmachr, Heilborn, and Gans, *Practice & Probate*, “Gifts by Fiduciaries by Tax Options and Elections on Fiduciary Tax Options and Elections” (November/December 2004). The definition of “authorized trustee” included in the proposed provision prevents the triggering of a gift in this instance because a trustee who is a beneficiary is not permitted to pay over the assets to a new trust.

(3) If the beneficiary or beneficiaries of the invaded trust are described by a class, the beneficiary or beneficiaries of the appointed trust may include present or future members of such class.”

“(b)(3) If the beneficiary or beneficiaries of the invaded trust are described by a class, the beneficiary or beneficiaries of the appointed trust shall include present or future members of such class.

(4) If the authorized trustee exercises the power under this paragraph and if the invaded trust grants a power of appointment to a beneficiary of the trust, the appointed trust shall grant such power of appointment in the appointed trust and the class of permissible appointees shall be the same as in the invaded trust.”

4. Explanation of Proposed Provision

In the case of a trust where a trustee has unlimited discretion, the proposed provision continues the requirement of the current statute that the appointed trust must be for the benefit of one, more or all of the current beneficiaries of the invaded trust. It is *not* necessary for the appointed trust to be for the benefit of *all* of the current beneficiaries of the invaded trust unless the beneficiaries have certain rights to withdraw or receive income or principal under the terms of the invaded trust (see discussion in B, above). The successor and remainder beneficiaries of the appointed trust do not have to be the same as the successor or remainder beneficiaries of the invaded trust; rather, the successor or remainder beneficiaries of the appointed trust must fall within the class of such beneficiaries identified in the invaded trust. In other words, the class of successor or remainder beneficiaries may be narrower than those named in the invaded trust.

The trustee may exclude any current beneficiary and any successor or remainder beneficiary of the invaded trust as a beneficiary of the appointed trust only if the trustees have unlimited or absolute discretion. If, however, the invaded trust does not give the trustee unlimited or absolute discretion to invade principal, the authorized trustee may not pay to an appointed trust with fewer than all of the current, successor and remainder beneficiaries of the invaded trust or grant a beneficiary a power to appoint.²⁸ (In addition, the appointed trust must include the same stated standard included in the invaded trust.²⁹)

With certain limitations, in the case of a trust where a trustee has unlimited discretion, the proposed provision specifically provides that an authorized trustee may pay to a trust that grants a power of appointment to one or more of the current beneficiaries of the invaded trust (including to a person who is a current member of the class or will become a member of the class in the future) provided the beneficiary granted a power to appoint could receive the principal outright.

²⁸ Proposed EPTL 10-6.6-A(b)

²⁹ Proposed EPTL 10-6.6-A(b)(1); for example, if the trustee’s discretion is limited to making distributions for a beneficiary’s health and support, the appointed trust must include that same standard. Note, if the invaded trust also gives a trustee the unlimited discretion to invade principal, then the trustee may exclude beneficiaries. *See* discussion in 13, above.

The power of appointment may be exercisable currently or in the future, *provided, however*, that the power may not be effective in a manner that will reduce, limit, or otherwise change mandatory distributions of income, or mandatory annuity or unitrust interests, or a right annually to withdraw a percentage of the value of the trust, or a right annual to withdraw a specified dollar amount.³⁰ The class of beneficiaries in favor of whom the beneficiary may exercise the power of appointment granted in the appointed trust may be broader than or otherwise different from the current, successor, and remainder beneficiaries of the invaded trust.

In the context of a trust where the trustee does not have unlimited discretion, the trustee must include a power of appointment in the appointed trust if the invaded trust contemplated the granting of a such a power and the class of permissible appointees must be the same as in the invaded trust.³¹ The Committees considered whether the appointed trust would have to include the same power of appointment granted in the invaded trust in light of the fact that the exercise of the power could be defeated by the trustee's payment of the trust fund outright to a beneficiary, but determined that it would be necessary to include that power because it was a preexisting right included in the invaded trust.

Examples

(Each of the examples is intended to make one or more specific points and is not intended to address all possible results stemming from the facts presented.)

Example 1: T is the trustee of a trust for the benefit of Beatrix. The trust is to terminate when Beatrix attains age 40. Beatrix is age 12. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix to continue for her entire lifetime.³²
- (b) The appointed trust may retain the same unlimited discretion standard contained in the invaded trust or contain a narrower standard (*e.g.*, the appointed trust may provide that distributions shall be made at the discretion of the trustee only for Beatrix' health, education, maintenance, and support).
- (c) T may grant Beatrix a special or general power of appointment presently exercisable or exercisable at a later point in time, such as at death.

Example 2: T is the trustee of a trust for the benefit of Beatrix, Bartholomew, and Benedict. The trust is to terminate when the youngest child, Benedict, attains age 25. Beatrix is age 12, Bartholomew is age 8, and Benedict is age 6. T has unlimited discretion to make distributions of principal to any of the beneficiaries.

- (a) T may pay the principal of the trust to an appointed trust that will last until the death of the survivor of Beatrix, Bartholomew, and Benedict.

³⁰ Proposed EPTL 10-6.6-A(a)(1)

³¹ Proposed EPTL 10-6.6-A(b)(4)

³² As noted above, this is consistent with current law, *See Matter of Riese, supra*, wherein trustees of an irrevocable trust subject to New York law which was to end at the first to die of the grantor and the beneficiary was paid to a new trust which was extended to last for the beneficiary's lifetime in order to protect the trust assets from the beneficiary's potential creditors.

- (b) T may pay the principal of the trust to an appointed trust for Beatrix and Benedict, or a trust exclusively for Beatrix, or any other combination of beneficiaries of the invaded trust.
- (c) The appointed trust may contain the same unlimited discretion standard contained in the invaded trust or include a narrower standard (*e.g.*, the appointed trust may provide that distributions shall be made to Beatrix, Bartholomew, and Benedict only for their health, education, maintenance, and support).

Example 3: T is the trustee of a trust for the benefit of Beatrix. Beatrix is entitled to receive one-third of the principal at age 35 and the balance at 40. Beatrix is age 35. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T must pay one-third of the principal outright to Beatrix. T may pay the balance of the principal of the trust to an appointed trust for Beatrix' lifetime.
- (b) The appointed trust may retain the same unlimited discretion standard contained in the invaded trust or include a narrower standard (*e.g.*, the appointed trust may provide that distributions shall be made to Beatrix only for her health, education, maintenance, and support).

Example 4: T is the trustee of a trust for the benefit of Beatrix. Beatrix is entitled to receive all of the trust income upon attaining age 25. The trust is to terminate when Beatrix attains age 40. Beatrix is age 25. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix' lifetime.
- (b) The appointed trust must give Beatrix the right to receive all of the trust income.
- (c) The appointed trust may grant a special or general power of appointment to Beatrix.

Example 5: T is the trustee of a trust for the benefit of Beatrix. Beatrix is entitled to receive all of the trust income upon attaining age 25. The trust is to terminate when Beatrix attains age 40. Beatrix is age 12. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix' lifetime.
- (b) The appointed trust does not have to provide for all of the trust income to be paid to Beatrix upon reaching the age of 25.
- (c) The appointed trust may grant to Beatrix a power to appoint principal to her issue and to any charity.

Example 6: T is the trustee of a trust for the benefit of Beatrix. Beatrix is entitled to withdraw the greater of \$5,000 or five percent of the trust principal on the last day of each calendar year. The trust is to terminate at Beatrix' death. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix' lifetime or for a shorter trust term.
- (b) The appointed trust must give Beatrix the right to withdrawal the greater of \$5,000 or five percent of the trust principal on the last day of each calendar year.

- (c) The appointed trust may grant a special or general power of appointment to Beatrix.

Example 7: T is the trustee of a trust for the benefit of Beatrix. The trust is to terminate when Beatrix attains age 40. Beatrix is age 12. T is required to distribute the income and principal to Beatrix for her health, education, maintenance, and support.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix' lifetime.
- (b) The appointed trust must retain the same standard of distribution (*i.e.*, T is required to distribute the principal to Beatrix for her health, education, maintenance, and support). The appointed trust may not expand T's authority to make distributions or give T greater discretion than in the invaded trust.
- (c) The appointed trust may not grant any beneficiary a special or general power of appointment unless such power was granted in the invaded trust.
- (d) Once Beatrix attains age 40, if the trust is still in existence, the appointed trust can provide that T has unlimited discretion to make principal distributions to Beatrix. It is not necessary for the appointed trust to retain the same standard of distribution after the term of the invaded trust would have otherwise ended.

Example 8: T is the trustee of a trust for the benefit of Beatrix, Bartholomew, and Benedict. The trust is to terminate when the youngest child, Benedict, attains age 25. Beatrix is age 12, Bartholomew is age 8, and Benedict is age 6. T has unlimited discretion to make distributions of principal to any of the beneficiaries. In addition, T is required to distribute income and principal to any of the beneficiaries for their health, education, maintenance, and support.

- (a) T may pay the principal of the trust to an appointed trust for the benefit of Beatrix, Bartholomew, and/or Benedict. It is not necessary for the appointed trust to be for the benefit of Beatrix, Bartholomew, and Benedict.
- (b) It is not necessary for the appointed trust to retain the same standard of distribution.
- (c) The appointed trust may grant to any beneficiary a special or general power of appointment.
- (d) If T pays the principal of the invaded trust to an appointed trust for the sole benefit of Beatrix, the appointed trust may grant a power of appointment to Bartholomew even though he is no longer a beneficiary of the trust.

Example 9: T is the trustee of a trust for the benefit of Beatrix (age 12), Bartholomew (age 8), and Benedict (age 6). T is required to distribute income and principal to any of the beneficiaries for their health, education, maintenance, and support until the youngest child attains age 30, at which time the trust terminates and is distributable in equal shares to Beatrix, Bartholomew, and Benedict, or their issue, *per stirpes*.

- (a) T may pay the principal of the trust to an appointed trust for the benefit of Beatrix, Bartholomew, and Benedict that will end at the later of Beatrix' lifetime and such time when all of Beatrix, Bartholomew, and Benedict attain age 30.
- (b) The appointed trust must retain the same standard of distribution (*i.e.*, T is required to distribute the principal to Beatrix, Bartholomew, and Benedict for his or her health, education, maintenance, and support).

- (c) Once the youngest child attains age 30, if the trust is still in existence, the appointed trust can provide that T has unlimited discretion to make principal distributions to Beatrix, Bartholomew, or Benedict. It is not necessary for the appointed trust to retain the same standard of distribution after the term of the invaded trust would have otherwise ended.
- (d) The appointed trust may grant to any beneficiary a special or general power of appointment after the term of the invaded trust would have otherwise ended.

Example 10: T is the trustee of a trust for the benefit of Beatrix. The trust is to terminate when Beatrix attains age 50 or sooner dies and the principal is to be held in further trust for Beatrix' issue, if any, or, if none, to the issue of her mother. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix for Beatrix' entire lifetime.
- (b) The remainder beneficiaries of the trust may be Beatrix' brothers or sisters and not her issue.
- (c) T may grant Beatrix a power to appoint (presently exercisable or exercisable at a later point in time, such as at death) to any of her issue or to charity.

Example 11: T is the trustee of a trust for the benefit of Beatrix and her spouse. The trust is to terminate when Beatrix attains age 40. Beatrix is age 30 and has no spouse. T has unlimited discretion to make principal distributions to Beatrix.

- (a) T may pay the principal of the trust to an appointed trust for Beatrix and her spouse for Beatrix' entire lifetime.
- (b) The appointed trust may be for the benefit of Beatrix and her spouse if she subsequently marries.
- (c) The appointed trust may grant a special or general power of appointment to Beatrix.

Example 12: T is the trustee of a trust for the benefit of Beatrix and her issue. The trust is to terminate when Beatrix attains age 40. Beatrix is age 30 and has one daughter. T has unlimited discretion to make distributions of principal to Beatrix and her issue.

- (a) T may pay the principal of the trust to an appointed trust only for Beatrix for Beatrix' entire lifetime.
- (b) The appointed trust may grant a special or general power of appointment to Beatrix.
- (c) The appointed trust may grant a special or general power of appointment to the youngest of Beatrix' children even though such child may or may not yet be living.
- (d) The appointed trust may include all of Beatrix' issue, even issue who are not yet lives in being.
- (e) The appointed trust may grant a special or general power of appointment to Beatrix' daughter even though she is no longer a beneficiary of the trust.

Example 13: T is the trustee of a trust for the benefit of Beatrix and Bartholomew. T has unlimited discretion to make distributions of principal to Beatrix; T may only distribute income to Bartholomew.

- (a) T may pay the principal of the invaded trust to an appointed trust for the benefit of Beatrix and Bartholomew or to a trust for the sole benefit of Beatrix. If the trust is also for the benefit of Bartholomew, Bartholomew may only receive distributions of income.
- (b) The appointed trust may retain the same unlimited discretion standard contained in the invaded trust or contain a narrower standard but cannot authorize distributions of principal to Bartholomew.
- (c) The appointed trust may grant a special or general power of appointment to Beatrix.
- (d) The appointed trust may not grant a general power of appointment to Bartholomew because under the terms of the invaded trust Bartholomew was only an income beneficiary.

D. TAX-SAVING PROVISIONS

1. Present Law

The current statute specifically provides that a trustee may not pay over to a new trust and reduce any current fixed income interest of any income beneficiary. This requirement is often necessary to avoid an adverse tax effect. Although it seems certain that the current statute does not permit any changes to the tax treatment relating to the funding of the invaded trust, to be effected by paying to a new trust, it is not free from doubt. Paying to a new trust might adversely impact the tax status of the trust or a right or power associated therewith as it does not explicitly so provide.

2. Reasons for Change

As a safeguard, it is appropriate that the statute expressly prohibit any trust changes that would adversely impact tax structuring relating to the invaded trust.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(m) If any contribution to the invaded trust qualified for the annual exclusion under section 2503(b) of the Code, the marital deduction under section 2056(a) or 2523(a) of the Code, or the charitable deduction under section 170(a), 642(c), 2055(a) or 2522(a) of the Code, is a direct skip qualifying for treatment under section 2642(c) of the Code, or qualified for any other specific tax benefit that would be lost by the existence of the authorized trustee’s authority under paragraph (a) or (b) for income, gift, estate, or generation-skipping transfer tax purposes under the Code, then the authorized trustee shall not have the power to invade the principal of a trust pursuant to paragraph (a) or (b) in a manner that would prevent the contribution to the invaded

trust from qualifying for or would reduce the exclusion, deduction, or other tax benefit which was originally claimed with respect to that contribution.

(1) Notwithstanding the foregoing, the authorized trustee may exercise the power to pay the invaded trust to a trust as to which the creator of the invaded trust is not considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code even if the creator is considered such owner of the invaded trust.

(2) During any period when the invaded trust owns S corporation stock, an authorized trustee may not exercise a power authorized by paragraph (a) or (b) to pay the S corporation stock to an appointed trust that is not a permitted shareholder under section 1361(c)(2) of the Code.

(3) During any period when the invaded trust owns an interest in property subject to the minimum distribution rules of Section 401(a)(9) of the Code, an authorized trustee may not exercise a power authorized by paragraph (a) or (b) to pay the interest in such property to an appointed trust that would result in the shortening of the minimum distribution period to which the property is subject in the invaded trust.”

4. Explanation of Proposed Provision

The proposed provision³³ includes language that would override the terms of the appointed trust or a trustee’s power under the statute to the extent that such terms or powers affect any right under the invaded trust that is necessary or required for tax purposes or to receive certain tax results or benefits that would otherwise be lost for income, gift, estate, or generation-skipping transfer tax purposes under the Code. The proposed provision confirms that a trustee shall not have the authority to change the invaded trust in a manner that would prevent the invaded trust from qualifying for or would reduce the exclusion, deduction, or other tax benefit which was originally claimed with respect to that contribution.³⁴ Specifically contemplated are contributions that qualified for (a) the annual exclusion under section 2503(b) of the Code, (b) the marital deduction under section 2056(a) or 2523(a) of the Code, (c) the charitable deduction under section 170(a), 642(c), 2055(a), or 2522(a) of the Code, and (d) a direct skip under section 2642(c) of the Code. For example, the appointed trust must retain the right of exercise of any outstanding withdrawal power and retain a beneficiary’s right to receive the principal of a trust created under section 2503(c) of the Code upon attaining age 21. Furthermore, if the invaded trust holds S corporation stock, that stock may not be paid to an appointed trust that is not a permitted shareholder within the meaning section 1361(c)(2) of the Code.³⁵ Similarly, the proposed provision provides that during any period when the invaded trust owns an interest in property subject to the minimum distribution rules of Section 401(a)(9) of the Code, an authorized trustee may not exercise a power to pay the interest in such property

³³ Proposed EPTL 10-6.6-A(m)

³⁴ The Committees note that even the ability of a trustee to take away a beneficiary’s five and five withdrawal power, for example, could cost the loss of the credit for tax on prior transfers under section 2013 of the Code.

³⁵ Proposed EPTL 10-6.6-A(m)(2)

to an appointed trust that would result in the shortening of the minimum distribution period to which the property is subject in the invaded trust.³⁶

Although grantor trust status is beneficial from a tax perspective, the proposed provision specifically provides that a trustee can change the trust from a grantor trust to a non-grantor trust.³⁷ Note, however, that nothing contained in the statute precludes the authorized trustee from paying assets from a non-grantor trust to a grantor trust, as such situation does not involve the “loss” of a tax benefit.

The Committees note that there may be circumstances when it might be advisable to modify the terms of an invaded trust in light of the changed economic or financial situation of the beneficiaries. For example, it may make economic sense to add a power of appointment to a trust otherwise exempt from estate tax to make the trust subject to estate tax in order to avoid generation-skipping transfer tax. Nothing contained in the statute is intended to preclude such a modification, so long as the modification does not negatively impact the tax return previously filed by the creator and the tax effect is not overall harmful.

Examples

Example 14: T is the trustee of a trust for the benefit of Beatrix. The trust is to terminate when Beatrix attains age 50. T has unlimited discretion to make principal distributions to Beatrix. The trust owns stock in an S corporation within the meaning of Section 1361(a) of the Code, and Beatrix has elected for the trust to be treated as a qualified subchapter S trust within the meaning of section 1361(d) of the Code. As a result of this election, *inter alia*, there may be only one income beneficiary of the trust, all of the trust income must be distributed currently to Beatrix, and any principal distributed during Beatrix’ life may only be distributed to Beatrix.

- (a) T may pay the S corporation stock to an appointed trust for Beatrix for Beatrix’ entire lifetime. So long as the trust continues to qualify as a qualified subchapter S trust or the trustee makes an election to treat the trust as an electing small business trust. All income of the appointed trust must be distributed to Beatrix if the trust is a qualified subchapter S trust.
- (b) Beatrix must remain the sole income and principal beneficiary of the appointed trust.³⁸

Example 15: T is the trustee of a trust for the benefit of Beatrix. The trust is to terminate when Beatrix attains age 50. T has unlimited discretion to make principal distributions to Beatrix. The invaded trust is a trust to which the creator of the invaded trust is not considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code. The authorized trustee can pay the principal of the trust to a trust that is a trust which the creator is considered the owner of under the Code.

³⁶ Proposed EPTL 10-6.6-A(m)(3)

³⁷ Proposed EPTL 10-6.6-A(m)(1)

³⁸ The Committees note that it may be necessary for Beatrix to make a new qualified subchapter S trust election within the necessary time periods as to the appointed trust.

E. ASSETS SUBJECT TO PAY-OVER TO APPOINTED TRUST

1. Present Law

The current statute does not address the scope of the assets subject to the power.

2. Reasons for Change

The statute would be clarified to provide that if all assets are paid from the invaded trust to the appointed trust, any accumulated undistributed income³⁹ and subsequently discovered assets or assets subsequently paid to the invaded trust or subsequently acquired by the invaded trust would also be transferred to the appointed trust. Unless specifically contemplated otherwise, to the extent that only a portion of trust assets are paid over to a new trust, subsequently discovered assets or assets subsequently paid to or acquired by the invaded trust would remain assets of the invaded trust.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(g) Unless the authorized trustee provides otherwise:

(1) The appointment of all of the assets comprising the principal of the invaded trust to an appointed trust shall include subsequently discovered assets of the invaded trust and undistributed principal of the invaded trust acquired after the appointment to the appointed trust.

(2) The appointment of part but not all of the assets comprising the principal of the invaded trust to an appointed trust shall not include subsequently discovered assets belonging to the invaded trust and principal paid to or acquired by the invaded trust after the appointment to the appointed trust; such assets shall remain the assets of the invaded trust.”

4. Explanation of Proposed Provision

The proposed provision provides that if all assets are paid from the invaded trust to the appointed trust, the exercise of the authorized trustee’s power shall apply to all of the assets comprising the undistributed income and principal of the invaded trust; any assets properly belonging to the invaded trust that are discovered subsequent to the exercise in favor of the appointed trust or subsequently paid to the invaded trust would also be deemed transferred to the appointed trust.⁴⁰ This would include any assets paid to the invaded trust from a pour-over

³⁹ Undistributed income is not added to principal under the EPTL. *See also* discussion in B, *supra*.

⁴⁰ Proposed EPTL 10-6.6-A(g)

will,⁴¹ as the appointed trust should be considered the continuation of the invaded trust. If part but not all of the assets are appointed to the appointed trust, subsequently discovered assets properly belonging to the invaded trust or assets subsequently paid to or acquired by the invaded trust would remain assets of the invaded trust.

F. BENEFICIARY NOTIFICATION REQUIREMENTS AND OBLIGATION TO FILE WITH THE COURT

1. Present Law

The current statute provides as follows:

- “A trustee described in subparagraph (1) of this paragraph may act thereunder without consent of any interested person and without prior court approval but is also authorized to seek such court approval, and the court having jurisdiction of the trust, upon the petition of the trustee and upon notice to all persons interested in the trust ...”⁴²
- “The exercise of the power to invade the principal of the trust ... shall be by an instrument in writing, signed and acknowledged by the trustee and filed in the office of the clerk of the court having jurisdiction over the trust; and a copy thereof shall be served on all persons interested in the trust (or on the guardian of the property, committee, conservator or personal representative of such persons or the parent or person with whom a minor resides), by registered or certified mail, return receipt requested, or by personal delivery or upon application of the trustee in any other manner directed by the court.”⁴³
- “For the purposes of this section, the phrase ‘all persons interested in the trust’ shall mean all the persons upon whom service of process would be required in a proceeding for the judicial settlement of the account of the trustee, taking into account section three hundred fifteen of the surrogate’s court procedure act.”⁴⁴

2. Reasons for Change

Although all beneficiaries do not have to be notified when a trustee makes a distribution of income or principal to a beneficiary and the trustees continue to be obligated to account to the beneficiaries when a trust is terminated or a substantial distribution is made, the Committees

⁴¹ EPTL 3-3.7 permits a pour-over disposition to an existing inter vivos trust, without regard to who created it or whether it is amended after the date of the will, provided the stated formalities for execution of the trust are observed. If assets under a will are directed to be paid to an invaded trust that was created before the date of the will but all of the assets of which have been paid to an appointed trust executed after the date of the will, there is an issue as to whether the assets from the will can be paid to the appointed trust because it was not created as of the date of the will. This issue is avoided if the appointed trust is recognized as a continuation of the invaded trust.

⁴² EPTL 10-6.6(b)(2)

⁴³ EPTL 10-6.6(d)

⁴⁴ EPTL 10-6.6(e)

recommend that the affirmative obligation to notify beneficiaries included in present law is retained in the proposed provision, but that the necessity to file any documents with the court is eliminated. The Committees also recommend that the settlor, if living, be notified of the exercise of the power. Furthermore, the proposed provision should clarify the current law ambiguity about whether such notification include a requirement that “all persons interested in the trust” must receive a copy of the appointed trust, by stating that it is not necessary to provide a copy, but requiring the trustees to provide a copy to any person notified of the exercise of the power who requests it.

The Committees considered whether a trustee should have to report why the trust assets are being paid over to a new trust and determined that reporting should not be a requirement for the pay over. The Committees note that the Uniform Trust Code, which is in the process of being adopted by a large number of states and could be adopted in New York, includes provisions enhancing a trustee’s discretionary powers. Also, the Committees note that because some trusts may be “decanted” for tax motivated reasons, explicit reporting of the tax motivation may subject the pay over to scrutiny by a taxing authority. Lastly, the Committees note that if a trustee is required to state the purpose of the pay over the pay over itself could be subject to review and challenged. For example, if the trustee exercises the power and pays the trust assets to a new trust that lasts for a beneficiary’s lifetime because the trustee is concerned about the beneficiary’s estranged marital status, this could leave open the possibility for the beneficiary to challenge the lifetime status of the appointed trust if the beneficiary subsequently mollifies the marital situation.

The Committees recognize that an authorized trustee’s power to pay over assets to a new trust may significantly impact a beneficiary’s rights and expectations, or could be used by the trustees to make secret changes to the dispositive provisions of the trust agreement, which are the principal reasons the Committees concluded that the beneficiaries should continue to be notified of the pay over. Although no actual consent is required, in light of the potential impact on beneficiaries, authorized trustees may want closure regarding the efficaciousness of the pay over without an accounting by obtaining the prior consent of all of the beneficiaries to the pay over. In those circumstances where consent is not obtained, the Committees considered whether the statute should contain a safe harbor whereby the trustee could be protected from liability for invading the trust if certain conditions are met, but concluded that the trustee may only limit liability for the pay over to the appointed trust if the trustee accounts.

As a practical matter, the Committees understand that the clerks of the courts have questioned the filing of the instruments exercising the power, sometimes not accepting the filing. In addition, it is sometimes unclear which court in which to file the instrument. It is also unclear whether the invaded trust agreement or the appointed trust agreement must be filed with the court. The Committees recommend that this ambiguity be addressed by altogether deleting the filing requirement.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(h)(1) An authorized trustee may exercise the power authorized by paragraphs (a) and (b) without the consent of the creator, or of the persons interested in the invaded trust, and without court approval, provided that

the authorized trustee may seek court approval for the exercise with notice to all persons interested in the invaded trust.

(2) A copy of the instrument exercising the power, together with a statement of the rights described in paragraph (h)(3), shall be delivered to the creator, if living, of the invaded trust and to any persons interested in the invaded trust (or, in the case of any persons interested in the trust, to any guardian of the property, conservator or personal representative of any such person or the parent or person with whom any such minor person resides), by registered or certified mail, return receipt requested, or by personal delivery or in any other manner directed by the court having jurisdiction over the invaded trust.

(3) Within 30 days after receipt by the authorized trustee of a written request therefor, the authorized trustee shall provide a copy of the invaded trust and the appointed trust to any person who is entitled to receive notice of the exercise of the power to appoint under paragraph (h)(2), by registered or certified mail, return receipt requested, or by personal delivery.”

“(5) The instrument exercising the power shall be kept with the records of the invaded trust and may be filed in any court having jurisdiction over the invaded trust.”

4. Explanation of Proposed Provision

The proposed provision retains the provision of present law regarding the duty of the trustee to exercise the power in a writing, signed and acknowledged, and to notify persons interested in the invaded trust of the exercise of the power by providing them with a copy of the instrument exercising the power to appoint by registered or certified mail or by personal delivery or in any other manner directed by a court. The proposed provision also requires the settlor of the invaded trust to receive a copy of the instrument exercising the power to appoint in the same manner as the persons interested in the invaded trust. The proposed provision affirmatively states that a copy of the appointed trust need only be provided to the beneficiaries or the settlor requesting a copy of the trust. If so requested, the authorized trustee must provide a copy of the appointed trust by registered or certified mail or by personal delivery within 60 days after the authorized trustee’s receipt of a request therefor. The proposed provision makes the court filing discretionary.⁴⁵

G. EFFECTIVE DATE

1. Present Law

The current statute does not address when the exercise of the power to appoint is effective.

⁴⁵ Proposed EPTL 10-6.6-A(h)

2. Reasons for Change

Establishing an effective date of the exercise of the power will avoid any possible ambiguities and confusion regarding the termination of the invaded trust and the determination of the assets of the appointed trust, in particular, what assets are subject to the pay over when less than all of the assets are paid to the appointed trust.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(h) The exercise of the power to appoint to an appointed trust under paragraph (a) or (b) shall be evidenced by an instrument in writing, signed, dated and acknowledged by the authorized trustee. If the authorized trustee delivers a copy of the instrument and statement as required in paragraph (h)(2) within 60 days after the date of the instrument, the exercise of the power shall be effective on the date set forth in the instrument exercising such power as the effective date or, if no such date is specified, on the date of the instrument. If a copy of the instrument and statement is not delivered within such 60 day period, the exercise of the power shall be effective 60 days after such delivery.”

4. Explanation of Proposed Provision

The proposed provision retains the provision of present law regarding the duty of the trustee to exercise the power in writing, signed and acknowledged, but also requires that the instrument be dated. The pay over will be effective on the date set forth in the instrument of transfer, or, if no such date is contemplated, the exercise will be effective 60 days after the date of the instrument. In either case, in order to be effective, the authorized trustee must deliver a copy of the instrument and statement describing the rights of the person receiving the statement within 60 days after the date of the instrument. If this 60 day notification period is not satisfied, the exercise of the power will not be effective until 60 days after such notice is delivered.

H. TRUSTEE LIABILITY FOR EXERCISE OF POWER

1. Present Law

The current statute does not address the trustee’s liability for exercising the power.

2. Reasons for Change

The statute should clarify that a trustee’s exercise of the power to appoint under the statute does not relieve the trustee from liability under the invaded trust and does not relieve the trustee from the liability to account both for the exercise of the power and for any action or inaction under the invaded trust.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(h)(4) The receipt of a copy of the instrument exercising the power shall not affect the right of any person interested in the invaded trust to compel the authorized trustee who exercised the power of appointment pursuant to paragraph (a) or (b) to account for such exercise and shall not foreclose any such interested person from objecting to an account or compelling a trustee to account.”

“(j) Nothing in this section is intended to create or imply a duty to exercise a power to invade principal, and no inference of impropriety shall be made as a result of an authorized trustee not exercising the power conferred under paragraph (a) or (b).”

4. Explanation of Proposed Provision

The delivery of a copy of the instrument exercising the power to any person interested in the trust shall not affect the right of any person interested in the invaded trust to compel the authorized trustee who exercised the power to account for such exercise and shall not commence any statute of limitations, or similar doctrine or law that would foreclose any such interested person from compelling a trustee to account.⁴⁶

I. TRUSTS TO WHICH THIS PROVISION APPLIES

1. Present Law

The current statute does not address specifically to which specific trusts the statute applies.

2. Reasons for Change

The statute would be clarified to provide that it applies to inter vivos and testamentary trusts initially subject to New York law and to trusts whose primary administration is transferred to the State of New York.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(p) Unless the invaded trust expressly provides otherwise, this section applies to:

(1) Any trust governed by the laws of this state, including a trust whose governing law has been changed to the laws of this state.

(2) Any trust that has a trustee who is an individual domiciled in this state or a trustee which is an entity having an office in this state, provided that a majority of the trustees select this state as the location for the primary administration

⁴⁶ Proposed EPTL 10-6.6-A(h)(4)

of the trust by an instrument in writing, signed and acknowledged by a majority of the trustees. The instrument exercising this selection shall be kept with the records of the invaded trust.”

4. Explanation of Proposed Provision

Unless the invaded trust expressly provides others, the proposed provision clarifies that the statute applies to (a) any inter vivos or testamentary trust (including a charitable trust) governed by the laws of the state of New York, including a trust whose primary administration initially is in another state but which trust’s primary administration is transferred to New York, and to (b) a trust that has a trustee who is an individual domiciled in this state or an entity which has an office in this state, if a majority of the trustees sign an acknowledged instrument kept with the records of the trust that provides that the primary administration of the trust will be located in New York.⁴⁷

J. TRUSTEE COMMISSIONS

1. Present Law

The current statute provides that a trustee may continue to receive commissions from a trust once the principal is paid over to a new trust so long as the aggregate annual and principal commissions of a trustee are not increased. Specifically, the statute provides as follows:

- “Unless the court upon application of the trustee otherwise directs, the aggregate annual and principal commissions of a trustee shall not be increased by its action under paragraph (b) of this section.”⁴⁸

2. Reasons for Change

It is uncertain under the current statute whether trustees of the appointed trust may continue to receive compensation if, by virtue of the pay over, a trust will last for a longer period of time, permitting the trustee to receive trustee commissions for a longer period of time. The statute is also uncertain in regard to whether a trustee may continue to receive the same amount of commissions from the appointed trust and as to whether the trustee may continue to receive commissions if the trustee has not been paid the full amount of commissions the trustee could have received from the invaded trust.

3. Relevant Portions of the Proposed Provision: EPTL 10-6.6-A

“(o)(1) Unless a court otherwise directs, an authorized trustee may not exercise a power authorized by paragraph (a) or (b) to change the provisions regarding the determination of the compensation of any trustee;

⁴⁷ Proposed EPTL 10-6.6-A(p)

⁴⁸ EPTL 10-6.6(c)

the commissions or other compensation payable to the trustees of the invaded trust may continue to be paid to the trustees of the appointed trust during the term of the appointed trust and shall be determined in the same manner as in the invaded trust.

(2) No trustee shall receive any paying commission or other compensation for appointing of property from the invaded trust to an appointed trust pursuant to paragraph (a) or (b).”

4. Explanation of Proposed Provision

The potential abuse prevented in the current statute is similarly prohibited in the proposed provision.⁴⁹ An authorized trustee may not change the compensation of any trustee unless the court upon application of the trustees otherwise directs. The proposed provision clarifies that the trustees may continue to receive compensation on the same basis as provided in the invaded trust during the term of the appointed trust, even if the term of the appointed trust is longer than the term of the invaded trust. Accordingly, a trustee may not receive compensation from an appointed trust to the extent the trustee was not entitled to compensation from the invaded trust; if the invaded trust prohibited or limited the payment of commissions, the trustee may not pay the assets to an appointed trust that permits the trustee to receive a greater amount of commissions.

The proposed provision also states that the trustee is not entitled to any commission or other compensation for appointing the property from the invaded trust to the appointed trust.

Examples

Example 16: T, an individual, is the trustee of a trust for the benefit of Beatrix. Beatrix is entitled to receive one-half of the principal at age 40 and all of the remaining principal at age 50. If Beatrix dies before attaining age 50, the principal is payable to her issue, or if none, to the issue of her parents. Beatrix is age 30. T has unlimited discretion to make principal distributions to Beatrix. T is entitled to receive commissions in such amounts as the laws of the State of New York in effect from time to time allow and has taken a full statutory commission pursuant to surrogate’s court procedure act section 2309 each year.⁵⁰

- (a) T may pay the principal of the trust to an appointed trust for the benefit of Beatrix for Beatrix’ entire lifetime.
- (b) T may continue to receive statutory commissions from the appointed trust.

Example 17: T, a corporation, and Beatrix, an individual (who is Bartholomew’s guardian), are trustees of a trust for the benefit of Bartholomew. Bartholomew is age 12, is an orphan, and lives with his guardian, Beatrix. Bartholomew is entitled to receive the entire principal at age 25. The trustees have unlimited discretion to make principal distributions to Bartholomew. T has

⁴⁹ Proposed EPTL 10-6.6-A(o)

⁵⁰ In general, each individual trustee, if no more than two are acting, is entitled to receive one percent of all distributions of trust principal, plus annual commissions of \$6,900 on the first \$1,000,000 of principal and \$3,000 on each additional \$1,000,000 of principal. If rents are collected, an additional six percent of gross rents is allowed as a commission.

taken compensation in accordance with its regularly published schedule of compensation. Beatrix is entitled to \$5,000 of commissions each year.

- (a) T and Beatrix may pay the principal of the trust to an appointed trust for the benefit of Bartholomew that will end when Bartholomew attains age 40.
- (b) For acting as trustee of the appointed trust, T may receive compensation in accordance with its regularly published schedule of compensation in effect at the time such compensation is paid and Beatrix may receive \$5,000 of commissions each year. Beatrix may not receive additional compensation over the \$5,000 each year; in order to receive such additional compensation, Beatrix will have to apply to the court with jurisdiction over the trust.

CONCLUSION

New York pioneered the realm of powers to appoint by enacting Section 10-6.6(b) in 1992. It is time again for New York to act as a vanguard and update and improve the statute, incorporating important provisions enacted by the other states or being considered by states, as well as adding significant, thoughtful, and creative elements, that are useful to practitioners but do not undermine the tenor of the statute. The Trusts, Estates and Surrogates Courts Committee and the Estate and Gift Taxation Committee of the Association of the Bar of the City of New York urge the revision of Section 10-6.6(b) as contemplated in this Memorandum in Support.

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NEW YORK
CITY BAR

Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

**Proposed Amendment to
Estates, Powers and Trusts Law Section 10-6.6(b) and
Restatement of the Statute as Section 10-6.6-A**

- (a) An authorized trustee with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust for, and only for the benefit of, one, more than one or all of the current beneficiaries of the invaded trust and one, more than one or all of the successor and remainder beneficiaries of the invaded trust (to the exclusion of any one or more of such current, successor, and remainder beneficiaries).
- (1) An authorized trustee exercising the power under this paragraph may grant a power of appointment (including a presently exercisable power of appointment) in the appointed trust to one or more of the current beneficiaries of the invaded trust, provided that the beneficiary granted a power to appoint could receive the principal outright under the terms of the invaded trust.
 - (2) If an authorized trustee grants a power of appointment, the permissible appointees may be broader than or different from any beneficiaries of the invaded trust.
 - (3) If the beneficiary or beneficiaries of the invaded trust are described by a class, the beneficiary or beneficiaries of the appointed trust may include present or future members of such class.
- (b) An authorized trustee with the power to invade trust principal but without unlimited discretion may appoint part or all of the principal of the trust to a trustee of an appointed trust, provided that the current beneficiaries of the appointed trust shall be the same as the current beneficiaries of the invaded trust and the successor and remainder beneficiaries of the appointed trust shall be the same as the successor and remainder beneficiaries of the invaded trust.
- (1) If the authorized trustee exercises the power under this paragraph, the appointed trust shall include the same language authorizing the trustee to distribute the income or invade the principal of the appointed trust as in the invaded trust.
 - (2) If the authorized trustee exercises the power under this paragraph to extend the term of the appointed trust beyond the term of the invaded trust, for any period after the invaded trust would have otherwise terminated under the

provisions of the invaded trust, the appointed trust may provide the trustees with unlimited discretion to invade the principal of the appointed trust during such extended term.

- (3) If the beneficiary or beneficiaries of the invaded trust are described by a class, the beneficiary or beneficiaries of the appointed trust shall include present or future members of such class.
 - (4) If the authorized trustee exercises the power under this paragraph and if the invaded trust grants a power of appointment to a beneficiary of the trust, the appointed trust shall grant such power of appointment in the appointed trust and the class of permissible appointees shall be the same as in the invaded trust.
- (c) An exercise of the power to invade trust principal under paragraphs (a) and (b) shall be considered the exercise of a special power of appointment as defined in 10-3.2.
 - (d) The appointed trust to which an authorized trustee appoints the assets of the invaded trust may have a term that is longer than the term set forth in the invaded trust, including, but not limited to, a term measured by the lifetime of a current beneficiary.
 - (e) If an authorized trustee has unlimited discretion to invade the principal of a trust and the same trustee or another trustee has the power to invade principal under the trust instrument which power is not subject to unlimited discretion, such authorized trustee having unlimited discretion may exercise the power of appointment under paragraph (a).
 - (f) An authorized trustee may exercise the power to appoint in favor of an appointed trust under paragraphs (a) and (b) whether or not there is a current need to invade principal under the terms of the invaded trust.
 - (g) Unless the authorized trustee provides otherwise:
 - (1) The appointment of all of the assets comprising the principal of the invaded trust to an appointed trust shall include subsequently discovered assets of the invaded trust and undistributed principal of the invaded trust acquired after the appointment to the appointed trust.
 - (2) The appointment of part but not all of the assets comprising the principal of the invaded trust to an appointed trust shall not include subsequently discovered assets belonging to the invaded trust and principal paid to or acquired by the invaded trust after the appointment to the appointed trust; such assets shall remain the assets of the invaded trust.
 - (h) The exercise of the power to appoint to an appointed trust under paragraph (a) or (b) shall be evidenced by an instrument in writing, signed, dated and acknowledged by the authorized trustee. If the authorized trustee delivers a copy of the instrument and statement as required in paragraph (h)(2) within 60 days after the date of the instrument, the exercise of the power shall be effective on the date set forth in the instrument exercising such power as the effective date or, if no such date is specified, on the date of the instrument. If a copy

of the instrument and statement is not delivered within such 60 day period, the exercise of the power shall be effective 60 days after such delivery.

- (1) An authorized trustee may exercise the power authorized by paragraphs (a) and (b) without the consent of the creator, or of the persons interested in the invaded trust, and without court approval, provided that the authorized trustee may seek court approval for the exercise with notice to all persons interested in the invaded trust.
 - (2) A copy of the instrument exercising the power, together with a statement of the rights described in paragraph (h)(3), shall be delivered to the creator, if living, of the invaded trust and to any persons interested in the invaded trust (or, in the case of any persons interested in the trust, to any guardian of the property, conservator or personal representative of any such person or the parent or person with whom any such minor person resides), by registered or certified mail, return receipt requested, or by personal delivery or in any other manner directed by the court having jurisdiction over the invaded trust.
 - (3) Within 30 days after receipt by the authorized trustee of a written request therefor, the authorized trustee shall provide a copy of the invaded trust and the appointed trust to any person who is entitled to receive notice of the exercise of the power to appoint under paragraph (h)(2), by registered or certified mail, return receipt requested, or by personal delivery.
 - (4) The receipt of a copy of the instrument exercising the power shall not affect the right of any person interested in the invaded trust to compel the authorized trustee who exercised the power of appointment pursuant to paragraph (a) or (b) to account for such exercise and shall not foreclose any such interested person from objecting to an account or compelling a trustee to account.
 - (5) The instrument exercising the power shall be kept with the records of the invaded trust and may be filed in any court having jurisdiction over the invaded trust.
- (i) This section shall not be construed to abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument of a trust or under any other provision of law or under common law, or as directed by any court having jurisdiction over the trust.
 - (j) Nothing in this section is intended to create or imply a duty to exercise a power to invade principal, and no inference of impropriety shall be made as a result of an authorized trustee not exercising the power conferred under paragraph (a) or (b).
 - (k) A power authorized by paragraph (a) or (b) may not be exercised if expressly prohibited by the terms of the governing instrument, but a general prohibition of the amendment or revocation of the invaded trust or a provision that constitutes a spendthrift clause shall not preclude the exercise of a power under paragraph (a) or (b).

- (l) An authorized trustee may not exercise a power authorized by paragraph (a) or (b) to effect any of the following:
 - (1) To reduce, limit or modify any beneficiary's current right to a mandatory distribution of income or principal, a mandatory annuity or unitrust interest, a right to withdraw a percentage of the value of the trust or a right to withdraw a specified dollar amount, provided that such mandatory right has come into effect with respect to the beneficiary. Notwithstanding the foregoing, but subject to the other limitations in this section, an authorized trustee may exercise a power authorized by paragraph (a) or (b) to appoint to an appointed trust that is a supplemental needs trust that conforms to the provisions of 7-1.12.
 - (2) To decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence and prudence.
 - (3) To eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the power under paragraph (a) or (b) unless a court having jurisdiction over the trust specifies otherwise.
 - (4) To make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise.
- (m) If any contribution to the invaded trust qualified for the annual exclusion under section 2503(b) of the Code, the marital deduction under section 2056(a) or 2523(a) of the Code, or the charitable deduction under section 170(a), 642(c), 2055(a) or 2522(a) of the Code, is a direct skip qualifying for treatment under section 2642(c) of the Code, or qualified for any other specific tax benefit that would be lost by the existence of the authorized trustee's authority under paragraph (a) or (b) for income, gift, estate, or generation-skipping transfer tax purposes under the Code, then the authorized trustee shall not have the power to invade the principal of a trust pursuant to paragraph (a) or (b) in a manner that would prevent the contribution to the invaded trust from qualifying for or would reduce the exclusion, deduction, or other tax benefit which was originally claimed with respect to that contribution.
 - (1) Notwithstanding the foregoing, the authorized trustee may exercise the power to pay the invaded trust to a trust as to which the creator of the invaded trust is not considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code even if the creator is considered such owner of the invaded trust.
 - (2) During any period when the invaded trust owns S corporation stock, an authorized trustee may not exercise a power authorized by paragraph (a) or (b) to pay the S corporation stock to an appointed trust that is not a permitted shareholder under section 1361(c)(2) of the Code.
 - (3) During any period when the invaded trust owns an interest in property subject to the minimum distribution rules of Section 401(a)(9) of the Code, an authorized trustee may not exercise a power authorized by paragraph (a)

or (b) to pay the interest in such property to an appointed trust that would result in the shortening of the minimum distribution period to which the property is subject in the invaded trust.

- (n) An authorized trustee may not exercise a power described in paragraph (a) or (b) in violation of the limitations under 9-1.1, 10-8.1 and 10-8.2, and any such exercise shall void the entire exercise of such power.
- (o)
 - (1) Unless a court otherwise directs, an authorized trustee may not exercise a power authorized by paragraph (a) or (b) to change the provisions regarding the determination of the compensation of any trustee; the commissions or other compensation payable to the trustees of the invaded trust may continue to be paid to the trustees of the appointed trust during the term of the appointed trust and shall be determined in the same manner as in the invaded trust.
 - (2) No trustee shall receive any paying commission or other compensation for appointing of property from the invaded trust to an appointed trust pursuant to paragraph (a) or (b).
- (p) Unless the invaded trust expressly provides otherwise, this section applies to:
 - (1) Any trust governed by the laws of this state, including a trust whose governing law has been changed to the laws of this state.
 - (2) Any trust that has a trustee who is an individual domiciled in this state or a trustee which is an entity having an office in this state, provided that a majority of the trustees select this state as the location for the primary administration of the trust by an instrument in writing, signed and acknowledged by a majority of the trustees. The instrument exercising this selection shall be kept with the records of the invaded trust.
- (q) For purposes of this section:
 - (1) The term “appointed trust” means an irrevocable trust which receives principal from an invaded trust under paragraph (a) or (b) including a new trust created by the creator of the invaded trust or by the trustees, in that capacity, of the invaded trust. For purposes of creating the new trust, the requirement of 7-1.17 that the instrument be signed by the creator shall be deemed satisfied by the signature of the trustee of the appointed trust.
 - (2) The term “authorized trustee” means, as to an invaded trust, any trustee or trustees with authority to pay trust principal to or for one or more current beneficiaries other than (i) the creator or (ii) a beneficiary to whom income or principal must be paid currently or in the future, or who is or will become eligible to receive a distribution of income or principal in the discretion of the trustee (other than by the exercise of a power of appointment held in a non-fiduciary capacity).
 - (3) References to sections of the “Code” refer to the United States Internal Revenue Code of 1986, as amended from time to time, or to corresponding

provisions of subsequent internal revenue laws, and also refer to corresponding provisions of state law.

- (4) The term “current beneficiary(ies)” means the person or persons (or as to a class, any person or persons who are or will become members of such class) to whom the trustees may distribute principal at the time of the exercise of the power.
 - (5) The term “invade” shall mean the power to pay directly to the beneficiary of a trust or make application for the benefit of the beneficiary.
 - (6) The term “invaded trust” means any existing irrevocable inter vivos or testamentary trust whose principal is appointed under paragraph (a) or (b).
 - (7) The term “person(s) interested in the invaded trust” shall mean any person(s) upon whom service of process would be required in a proceeding for the judicial settlement of the account of the trustee, taking into account section 315 of the surrogate’s court procedure act.
 - (8) The term “principal” shall include the income of the trust at the time of the exercise of the power that is not currently required to be distributed, including accrued and accumulated income.
 - (9) The term “unlimited discretion” means the unlimited right to distribute principal that is not modified in any manner. A power to pay principal that includes words such as best interests, welfare, comfort, or happiness shall not be considered a limitation or modification of the right to distribute principal.
- (r) This statute takes effect on _____.